

STATE OF UTAH

COMPREHENSIVE ANNUAL FINANCIAL REPORT



FOR THE FISCAL YEAR ENDED JUNE 30, 2004

State Of Utah
COMPREHENSIVE ANNUAL FINANCIAL REPORT
For The Fiscal Year Ended June 30, 2004

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State of Utah
COMPREHENSIVE ANNUAL FINANCIAL REPORT

For the Fiscal Year Ended June 30, 2004

Table of Contents

INTRODUCTORY SECTION

| | Page |
|--|------|
| Title page – Acknowledgments | 1 |
| Table of Contents | 2 |
| Letter of Transmittal | 4 |
| Certificate of Achievement for Excellence in Financial Reporting | 9 |
| State of Utah Organization Chart | 10 |

FINANCIAL SECTION

| | |
|--|----|
| Independent State Auditor's Report | 12 |
| Management's Discussion and Analysis | 14 |

Basic Financial Statements

| | |
|---|----|
| Government-wide Financial Statements | |
| Statement of Net Assets | 27 |
| Statement of Activities | 28 |
| Governmental Fund Financial Statements | |
| Balance Sheet | 32 |
| Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Assets | 34 |
| Statement of Revenues, Expenditures, and Changes in Fund Balances | 36 |
| Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds to the Statement of Activities | 38 |
| Proprietary Fund Financial Statements | |
| Statement of Net Assets | 40 |
| Statement of Revenues, Expenses, and Changes in Fund Net Assets | 42 |
| Statement of Cash Flows | 44 |
| Fiduciary Fund Financial Statements | |
| Statement of Fiduciary Net Assets | 49 |
| Statement of Changes in Fiduciary Net Assets | 50 |
| Component Unit Financial Statements | |
| Combining Statement of Net Assets | 52 |
| Combining Statement of Activities | 54 |
| Notes to the Financial Statements | 56 |

Required Supplementary Information

| | |
|--|-----|
| Budgetary Comparison Schedule – General Fund | 106 |
| Budgetary Comparison Schedule – Uniform School Fund | 107 |
| Budgetary Comparison Schedule – Transportation Fund | 108 |
| Budgetary Comparison Schedule – Centennial Highway Fund | 109 |
| Budgetary Comparison Schedule – Budget to GAAP Reconciliation | 110 |
| Notes to Required Supplementary Information – Budgetary Reporting | 111 |
| Information about Infrastructure Assets Reported Using the Modified Approach | 112 |

Supplementary Information – Combining Statements and Individual Fund Statements and Schedules

| | |
|--|-----|
| Governmental Funds | |
| Nonmajor Governmental Funds | |
| Combining Balance Sheet | 118 |
| Combining Statement of Revenues, Expenditures, and Changes in Fund Balances | 122 |
| Budgetary Compliance | |
| Detail Schedule of Expenditures – Budget and Actual Comparison – General Fund | 126 |
| Detail Schedule of Expenditures – Budget and Actual Comparison – Uniform School Fund, Transportation Fund, Centennial Highway Fund, and Debt Service Funds | 138 |

Supplementary Information – Combining Statements and Individual Fund Statements and Schedules (continued)**Proprietary Funds****Nonmajor Enterprise Funds**

| | |
|---|-----|
| Combining Statement of Net Assets | 142 |
| Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets | 144 |
| Combining Statement of Cash Flows | 146 |

Internal Service Funds

| | |
|---|-----|
| Combining Statement of Net Assets | 152 |
| Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets | 154 |
| Combining Statement of Cash Flows | 156 |

Fiduciary Funds**Defined Benefit Pension Plans and Other Pension Trust Funds**

| | |
|--|-----|
| Combining Statement of Fiduciary Net Assets | 162 |
| Combining Statement of Changes in Fiduciary Net Assets | 164 |

Private Purpose Trust Funds

| | |
|--|-----|
| Combining Statement of Fiduciary Net Assets | 166 |
| Combining Statement of Changes in Fiduciary Net Assets | 168 |

Agency Funds

| | |
|--|-----|
| Combining Statement of Fiduciary Assets and Liabilities | 170 |
| Combining Statement of Changes in Assets and Liabilities | 171 |

Component Units**Nonmajor Component Units**

| | |
|---|-----|
| Combining Statement of Net Assets | 174 |
| Combining Statement of Activities | 176 |

STATISTICAL SECTION

| | |
|--|-----|
| General Governmental Expenditures and Other Uses by Function – For the Last Ten Fiscal Years | 180 |
| General Governmental Revenues by Source and Liquor Control Profit Transfer – For the Last Ten Fiscal Years | 181 |
| General Obligation Bonds | 182 |
| Ratio of Net General Bonded Debt to Fair Market Value and Net Bonded Debt Per Capita – For the | |
| Last Ten Fiscal Years | 182 |
| Calculation of Legal Debt Limits – For the Last Ten Fiscal Years | 183 |
| Statutory Debt Limit | 183 |
| Net General Obligation Bonded Debt Per Capita – For the Last Ten Fiscal Years | 183 |
| Ratio of Debt Service Expenditures to General and to All Governmental Fund Type Expenditures – For the | |
| Last Ten Fiscal Years | 184 |
| Enterprise Funds Revenue Bond Coverage – For the Last Ten Fiscal Years | 184 |
| Revenue Bonds | 185 |
| Population | 191 |
| Taxable Retail Sales and Personal Income | 191 |
| Personal Income by Sector – For the Last Three Calendar Years | 192 |
| Composition of Labor Force – Annual Average – For the Last Four Calendar Years | 193 |
| Average Annual Unemployment Rate – For the Last Five Calendar Years | 193 |
| Gross Taxable Retail Sales and Use Tax Purchases – For the Last Five Calendar Years | 194 |
| Bank Deposits – For the Last Ten Fiscal Years | 194 |
| Largest Employers | 195 |
| Graph of Revenues and Expenditures – All Governmental Fund Types – For the Last Five Fiscal Years | 196 |
| Graph of Expenditures – Historical and Constant Dollars – All Governmental Fund Types – For the | |
| Last Five Fiscal Years | 197 |
| Graph of Per Capita Expenditures – Historical and Constant Dollars – All Governmental Fund Types – For the | |
| Last Five Fiscal Years | 198 |

INTRODUCTION

The following is a discussion and analysis of the State of Utah's financial performance and position, providing an overview of the State's activities for the fiscal year ended June 30, 2004. Please read it in conjunction with the transmittal letter in the Introductory Section of this report and with the State's financial statements that follow this section.

HIGHLIGHTS

Government-wide

- The State's net assets increased \$530.7 million or 5.1 percent over the prior year. Net assets of governmental activities increased \$482.1 million or 5.4 percent due to an improving economy and active resource management. Net assets of business-type activities remained relatively stable, increasing by \$48.6 million or 3.2 percent.

Fund Level

- Combined tax revenues were 5.3 percent higher in the General Fund and 7.4 percent higher in the Uniform School Fund than the prior year as Utah's economy showed signs of improvement. The State's economic slowdown in 2002 and 2003 and subsequent improvement in fiscal year 2004 is similar to the trend of the national economy.
- The General Fund and Uniform School Fund ended the fiscal year with "surplus" from unreserved and undesignated sources of \$44.8 million and \$50.7 million, respectively. By law, half of the General Fund surplus, or \$22.4 million, was transferred to the Budget Reserve Account ("Rainy Day Fund"). Twenty-five percent of the Uniform School Fund surplus, or \$12.7 million was transferred to the Education Budget Reserve Account.

Long-term Debt

- The State's long-term bonded debt decreased a net \$35.1 million or 1.0 percent. General obligation debt decreased \$125 million or 7.3 percent, primarily due to timing, as bonds normally issued at the beginning of the fiscal year were issued at the end of the prior year. Revenue bonded debt increased \$89.9 million or 5.4 percent, as additional bonds were issued to fund capital facility construction and student loan programs.

OVERVIEW OF THE FINANCIAL STATEMENTS

This report includes the State's Basic Financial Statements, Required Supplementary Information, and Supplementary Information. The Basic Financial Statements include three components: government-wide financial statements, fund financial statements, and notes to the financial statements.

Government-wide Statements – Reporting the State as a Whole

The Statement of Net Assets and the Statement of Activities beginning on page 27 together comprise the *government-wide financial statements*. These statements provide a broad overview with a long-term focus of the State's finances as a whole and are prepared using the *full-accrual* basis of accounting, similar to private-sector companies. This means all revenues and expenses are recognized regardless of when cash is received or spent, and all assets and liabilities, including capital assets and long-term debt, are reported at the entity level.

The government-wide statements report the State's *net assets* – the difference between total assets and total liabilities – and how they have changed from the prior year. Over time, increases and decreases in net assets measure whether the State's overall financial condition is getting better or worse. In evaluating the State's overall condition, however, additional non-financial factors should be considered such as the State's economic outlook, changes in its demographics, and the condition of its capital assets and infrastructure. The government-wide statements report three activities:

Governmental Activities – Most of the State's basic services fall under this activity including education, transportation, public safety, courts, corrections, health, and human services. Taxes and federal grants are the major funding sources for these programs.

Business-type Activities – The State operates certain activities much like private-sector companies by charging fees to customers to cover all or most of the costs of providing the goods and services. Student loans, unemployment compensation, water project loan programs, and liquor sales are examples of business-type activities.

Component Units – Several entities are legally separate from the State, yet the State remains financially accountable for them. Colleges and Universities, Utah Housing Corporation, and Utah State Fair Corporation are examples of component units.

Fund Financial Statements – Reporting the State's Most Significant Funds

The fund financial statements beginning on page 32 provide detailed information about individual major funds, not the State as a whole. A fund is a group of related accounts that the State uses to keep track of specific resources that are segregated for a specific purpose. Some funds are required by law to exist, while others are established internally to maintain control over a particular activity. All of the State's funds are divided into three types, each of which uses a different accounting approach.

Governmental Funds – Most of the State's basic services are accounted for in governmental funds and are essentially the same functions reported as *governmental activities* in the government-wide statements. Governmental funds use the *modified accrual* basis of accounting, which measures the flow of current financial resources that can be converted to cash and the balances left at year end that are available for future spending. This *short-term* view of the State's financial position helps determine whether the State has sufficient resources to cover expenditures for its basic services in the near future.

Proprietary Funds – Proprietary funds include enterprise funds and internal service funds and account for state activities that are operated much like private-sector businesses. Like the government-wide statements, proprietary fund statements are presented using the *full-accrual* basis of accounting. Activities whose customers are mostly outside of state government (e.g., water loan funds to local governments) are accounted for in *enterprise funds* and are the same functions reported as *business-type activities*. Thus, the *enterprise fund* financial statements reinforce the information reported for *business-type* activities in the government-wide statements, but provide more detail and additional information, such as cash flows. Activities whose customers are mostly other state agencies (e.g., motor pool) are accounted for in *internal service funds*. The internal service fund activities are consolidated with the governmental activities in the government-wide statements because those services predominantly benefit governmental rather than business-type activities.

Fiduciary Funds – Fiduciary funds account for assets that, because of trust relationships, can be used only for trust beneficiaries. The State is responsible for ensuring these assets are used for their intended purposes. Fiduciary funds use *full-accrual* accounting but are *not* included in the government-wide statements because their assets are not available to finance the State's own programs.

Reconciliation Between Government-wide and Fund Statements

The financial statements include schedules on pages 34 and 38 that reconcile and explain the differences between the amounts reported for *governmental activities* on the government-wide statements (full-accrual accounting, long-term focus) with amounts reported on the *governmental* fund statements (modified accrual accounting, short-term focus). Following are some of the major differences between the two statements:

- Capital assets and long-term debt are included on the government-wide statements but are not reported on the governmental fund statements.
- Capital outlay spending results in capital assets on the government-wide statements but are expenditures on the governmental fund statements.
- Bond proceeds result in liabilities on the government-wide statements but are other financing sources on the governmental fund statements.
- Certain tax revenues that are earned but not yet available are reported as revenue on the government-wide statements but are deferred revenue on the governmental fund statements.

Notes to the Financial Statements

The notes beginning on page 56 provide additional schedules and information that are essential to a complete understanding of the financial statements. The notes apply to both the government-wide financial statements and the fund financial statements.

Required Supplementary Information (RSI)

Following the Basic Financial Statements are budgetary comparison schedules for major funds with legally adopted budgets and condition assessment data related to infrastructure. RSI further supports the information in the basic financial statements.

Supplementary Information

Supplementary Information includes combining statements for the State's nonmajor governmental, nonmajor proprietary, and fiduciary funds and for nonmajor discretely presented component units. This section also includes schedules which compare budgeted expenditures to actual results at the legal level of control, which is generally the line item level of the *Appropriation Acts*.

Adjustments to Beginning Net Assets

As described in Note 2 of the financial statements on page 63, beginning net assets of governmental activities were reduced by \$290.7 million for capital asset adjustments and increased by \$14 million to accrue estimated tobacco settlement monies due to the State. To enhance comparability, all amounts presented for governmental activities for fiscal year 2003 in this discussion and analysis were revised, where applicable, to reflect these changes as if the changes had been made in the prior year.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

Net Assets. The State's total net assets increased \$530.7 million or 5.1 percent in fiscal year 2004. In comparison, net assets in the prior year increased \$262.6 million or 2.5 percent. This increase in net assets resulted from an improving economy and the active management of state resources. Approximately \$280.7 million of the increase was in net capital assets as the State's investment in highways and buildings exceeded depreciation and net additional debt to finance projects. The increase in restricted net assets of governmental activities resulted primarily from an increase in unspent carry forward funds of \$70 million for education, an increase of \$54.1 million in tax revenue restricted for education on a full accrual basis, and net earnings of \$87.1 million in the permanent Trust Lands Fund. Restricted net assets decreased slightly in business-type activities primarily due to unemployment claims exceeding related revenue, even though total unemployment claims dropped. The decrease in unrestricted net assets of governmental activities was mainly due to an increase in the completion and transfer of state-financed buildings to colleges with the related debt of approximately \$127 million remaining with the State. This amount was partially offset by an increase in General Fund unrestricted carry forward balances of \$96.3 million. The increase in unrestricted net assets of business-type activities was the result of normal operations and is primarily due to the State adding additional capital to loan funds from sales taxes and mineral lease revenues. Net assets of business-type activities generally can be used only to finance the business-type activities' ongoing operations.

State of Utah
Net Assets as of June 30
(Expressed in Thousands)

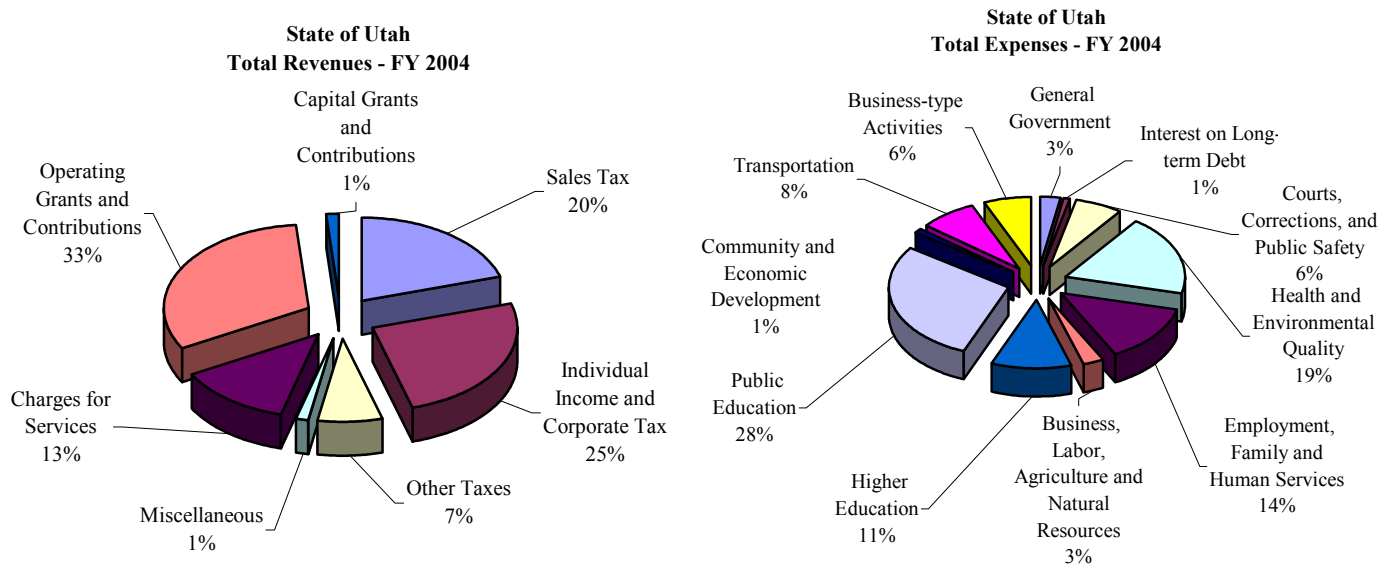
| | Governmental Activities | | Business-type Activities | | Total Primary Government | |
|--|--------------------------------|---------------------|---------------------------------|---------------------|---------------------------------|----------------------|
| | 2004 | 2003 | 2004 | 2003 | 2004 | 2003 |
| Current and Other Assets | \$ 2,949,835 | \$ 2,846,827 | \$ 3,021,668 | \$ 2,880,978 | \$ 5,971,503 | \$ 5,727,805 |
| Capital Assets | 9,521,749 | 9,223,710 | 57,726 | 51,220 | 9,579,475 | 9,274,930 |
| Total Assets | 12,471,584 | 12,070,537 | 3,079,394 | 2,932,198 | 15,550,978 | 15,002,735 |
| Current and Other Liabilities | 647,391 | 643,232 | 37,300 | 38,654 | 684,691 | 681,886 |
| Long-term Liabilities | 2,371,186 | 2,456,410 | 1,489,054 | 1,389,095 | 3,860,240 | 3,845,505 |
| Total Liabilities | 3,018,577 | 3,099,642 | 1,526,354 | 1,427,749 | 4,544,931 | 4,527,391 |
| Net Assets: | | | | | | |
| Invested in Capital Assets, | | | | | | |
| Net of Related Debt | 7,939,771 | 7,661,130 | 24,141 | 22,104 | 7,963,912 | 7,683,234 |
| Restricted | 1,207,428 | 973,636 | 804,745 | 814,147 | 2,012,173 | 1,787,783 |
| Unrestricted | 305,808 | 336,129 | 724,154 | 668,198 | 1,029,962 | 1,004,327 |
| Total Net Assets | \$ 9,453,007 | \$ 8,970,895 | \$ 1,553,040 | \$ 1,504,449 | \$ 11,006,047 | \$ 10,475,344 |
| Percent change in total net assets from prior year | 5.4 % | | 3.2 % | | 5.1 % | |

The largest component of the State's net assets, 72.4 percent, reflects investments in capital assets (land, buildings, equipment, roads, and other infrastructure) less the outstanding debt issued to finance those assets. As capital assets, these resources are not available for future spending, nor can they be readily liquidated to pay off their related liabilities. Resources needed to repay capital-related debt must be provided from other sources.

Restricted net assets comprise 18.3 percent of total net assets and are subject to constitutional, legal, or external constraints on how they can be used. Net assets that are restricted by the *Constitution of Utah* include income and corporate taxes that can be used only for public and higher education costs and for motor fuel taxes that can be used only for transportation expenses.

The remaining balance of unrestricted net assets may be used to meet the State's ongoing obligations, though certain laws and internally imposed designations of resources further limit the purposes for which many of those net assets may be used.

The charts on the following page summarize the State's total revenues, expenses, and changes in net assets for fiscal year 2004.



**State of Utah
Changes in Net Assets
for the Fiscal Year Ended June 30
(Expressed in Thousands)**

| | Governmental Activities | | Business-type Activities | | Total Primary Government | | Total Percentage Change |
|--------------------------------------|-------------------------|---------------------|--------------------------|---------------------|--------------------------|----------------------|-------------------------|
| | 2004 | 2003 | 2004 | 2003 | 2004 | 2003 | 2003 to 2004 |
| Revenues | | | | | | | |
| General Revenues: | | | | | | | |
| Taxes | \$ 4,041,389 | \$ 3,784,924 | \$ 14,402 | \$ 2,180 | \$ 4,055,791 | \$ 3,787,104 | 7.1 % |
| Other General Revenues | 88,982 | 97,267 | 2,089 | 3,212 | 91,071 | 100,479 | (9.4) |
| Program Revenues: | | | | | | | |
| Charges for Services | 558,848 | 472,610 | 416,828 | 353,138 | 975,676 | 825,748 | 18.2 |
| Operating Grants and Contributions | 2,347,510 | 2,034,177 | 92,141 | 130,235 | 2,439,651 | 2,164,412 | 12.7 |
| Capital Grants and Contributions | 105,149 | 123,883 | — | — | 105,149 | 123,883 | (15.1) |
| Total Revenues | 7,141,878 | 6,512,861 | 525,460 | 488,765 | 7,667,338 | 7,001,626 | 9.5 |
| Expenses | | | | | | | |
| General Government | 189,645 | 194,211 | — | — | 189,645 | 194,211 | (2.4) |
| Human Services and Youth Corrections | 581,286 | 538,492 | — | — | 581,286 | 538,492 | 7.9 |
| Corrections, Adult | 199,710 | 184,805 | — | — | 199,710 | 184,805 | 8.1 |
| Public Safety | 152,058 | 127,861 | — | — | 152,058 | 127,861 | 18.9 |
| Courts | 99,510 | 106,045 | — | — | 99,510 | 106,045 | (6.2) |
| Health and Environmental Quality | 1,343,115 | 1,177,121 | — | — | 1,343,115 | 1,177,121 | 14.1 |
| Higher Education | 781,468 | 647,572 | — | — | 781,468 | 647,572 | 20.7 |
| Employment and Family Services | 386,974 | 352,082 | — | — | 386,974 | 352,082 | 9.9 |
| Natural Resources | 121,214 | 119,528 | — | — | 121,214 | 119,528 | 1.4 |
| Community and Economic Development | 88,166 | 90,794 | — | — | 88,166 | 90,794 | (2.9) |
| Business, Labor, and Agriculture | 72,886 | 66,965 | — | — | 72,886 | 66,965 | 8.8 |
| Public Education | 2,039,641 | 1,981,119 | — | — | 2,039,641 | 1,981,119 | 3.0 |
| Transportation | 541,566 | 523,591 | — | — | 541,566 | 523,591 | 3.4 |
| Interest on Long-term Debt | 75,935 | 73,835 | — | — | 75,935 | 73,835 | 2.8 |
| Student Assistance Programs | — | — | 82,739 | 86,995 | 82,739 | 86,995 | (4.9) |
| Unemployment Compensation | — | — | 242,828 | 307,834 | 242,828 | 307,834 | (21.1) |
| Water Loan Programs | — | — | 6,730 | 7,074 | 6,730 | 7,074 | (4.9) |
| Other Business-type Activities | — | — | 131,164 | 123,706 | 131,164 | 123,706 | 6.0 |
| Total Expenses | 6,673,174 | 6,184,021 | 463,461 | 525,609 | 7,136,635 | 6,709,630 | 6.4 |
| Excess (Deficiency) Before Transfers | 468,704 | 328,840 | 61,999 | (36,844) | 530,703 | 291,996 | |
| Transfers | 13,408 | 24,237 | (13,408) | (24,237) | — | — | |
| Change in Net Assets | 482,112 | 353,077 | 48,591 | (61,081) | 530,703 | 291,996 | |
| Net Assets – Beginning as Adjusted | 8,970,895 | 8,617,818 | 1,504,449 | 1,565,530 | 10,475,344 | 10,183,348 | |
| Net Assets – Ending | \$ 9,453,007 | \$ 8,970,895 | \$ 1,553,040 | \$ 1,504,449 | \$ 11,006,047 | \$ 10,475,344 | 5.1 % |

Changes in Net Assets. This year the State received 52.9 percent of its revenues from state taxes and 33.2 percent of its revenues from grants and contributions, mostly from federal sources. In the prior year, state taxes accounted for 54.1 percent, and grants and contributions were 32.7 percent of total revenues. Charges for goods and services such as licenses, permits, liquor sales, state parks, and court fees, combined with other miscellaneous collections, comprised 13.9 percent of total revenues in fiscal year 2004, compared with 13.2 percent in fiscal year 2003.

Governmental Activities

The State's total governmental revenues from all sources increased \$629 million or 9.7 percent. Tax revenues increased \$256.5 million or 6.8 percent. This increase in taxes reflects an improvement in economic conditions and is similar to the increase at the fund level. However, due to differences in measurement focus, timing of collections, and lack of historical accrued tax information, the increase at the government-wide level should not be used to predict future increases at the fund statement or budget level. With the exception of higher education expenses, other significant changes in governmental activities' revenues and expenses mirror the changes in the General Fund at the fund level. For further discussion of these changes, see the section titled "General Fund" on page 19. While part of the increase in higher education expenses was due to an increase in general state support, a significant part was due to an increase of \$118.5 million in the amount spent for building projects completed for colleges and universities.

The table below shows to what extent the State's governmental activities relied on taxes and other general revenues to cover all of their costs. For fiscal year 2004, state taxes and other general revenues covered 54.9 percent of expenses. The remaining \$3.012 billion or 45.1 percent of the total expenses were generated through charges for services and grants.

State of Utah
Net Cost of Governmental Activities
for the Fiscal Year Ended June 30
(Expressed in Thousands)

| | Program Expenses 2004 | Less Program Revenues 2004 | Net Program Costs | | Program Revenues as a Percentage of Program Expenses | |
|--------------------------------------|-----------------------------|-------------------------------------|-------------------------|---------------------|--|---------------|
| | | | 2004 | 2003 | 2004 | 2003 |
| General Government | \$ 189,645 | \$ (193,201) | \$ (3,556) | \$ 34,781 | 101.9 % | 81.8 % |
| Human Services and Youth Corrections | 581,286 | (286,848) | 294,438 | 266,082 | 49.3 | 50.6 |
| Corrections, Adult | 199,710 | (7,970) | 191,740 | 177,801 | 4.0 | 3.8 |
| Public Safety | 152,058 | (90,833) | 61,225 | 61,123 | 59.7 | 52.2 |
| Courts | 99,510 | (33,571) | 65,939 | 76,350 | 33.7 | 28.0 |
| Health and Environmental Quality | 1,343,115 | (1,082,487) | 260,628 | 262,258 | 80.6 | 77.7 |
| Higher Education | 781,468 | (1,039) | 780,429 | 646,054 | 0.1 | 0.2 |
| Employment and Family Services | 386,974 | (344,238) | 42,736 | 40,768 | 89.0 | 88.4 |
| Natural Resources | 121,214 | (79,476) | 41,738 | 38,768 | 65.6 | 67.6 |
| Community and Economic Development | 88,166 | (41,701) | 46,465 | 51,245 | 47.3 | 43.6 |
| Business, Labor, and Agriculture | 72,886 | (64,088) | 8,798 | 9,285 | 87.9 | 86.1 |
| Public Education | 2,039,641 | (408,794) | 1,630,847 | 1,647,523 | 20.0 | 16.8 |
| Transportation | 541,566 | (377,261) | 164,305 | 199,254 | 69.7 | 68.1 |
| Interest on Long-term Debt | 75,935 | — | 75,935 | 73,835 | | |
| Total Governmental Activities | \$ 6,673,174 | \$ (3,011,507) | \$ 3,661,667 | \$ 3,585,127 | 45.1 % | 42.5 % |

Business-type Activities

Revenues from the State's business-type activities increased \$36.7 million or 7.5 percent from the prior year. This increase is largely due to an increase in collections in the Unemployment Compensation Fund of \$19.7 million as higher claims in recent years resulted in increased employer taxes of \$50.3 million, offset by lower federal reimbursements. Because Utah's employment situation improved over the prior year, unemployment benefit claims expenses dropped \$65 million or 21.1 percent. This decrease was the primary reason for the overall decrease in business-type activities' expenditures of \$62.3 million.

All of the State's business-type activities operate from program revenues, except for the Water Loan Programs and the Agriculture Loan Fund that by law receive dedicated sales taxes and the Community Impact Loan Fund that receives federal mineral lease revenues to provide additional capital for loans. Accounting standards require unemployment taxes that are collected from employers and deposited in the Unemployment Compensation Fund be reported as charges for services rather than taxes. Therefore, taxes in the business-type activities are comprised entirely of sales taxes in the water and agriculture loan programs. For fiscal year 2004, dedicated sales taxes increased by \$12.2 million as the Legislature restored tax revenues that were redirected to the General Fund in 2003 to help balance the budget.

FINANCIAL ANALYSIS OF THE STATE'S GOVERNMENTAL FUNDS

Fund Balances

At June 30, 2004, the State's governmental funds reported combined ending fund balances of \$1.953 billion. Of this amount, \$1.047 billion or 53.6 percent is reserved for specific programs by state law, by external constraints, or by contractual obligations. Unspent bond proceeds, balances of restricted accounts, and agencies' nonlapsing balances are included in reserved fund balance. An additional \$534 million or 27.4 percent of total fund balances has been designated through internally imposed limitations on uses of certain funds. Note 11 on page 92 contains more details about reserved and designated fund balances at June 30, 2004. The remaining \$371.6 million or 19.0 percent of fund balance is available for appropriation for the general purposes of the funds.

State of Utah
Governmental Fund Balances as of June 30, 2004
(Expressed in Thousands)

| | General Fund | Uniform School Fund | Transportation Fund | Centennial Highway Fund | Trust Lands Fund | Nonmajor Funds | Total |
|--------------------------------|---------------------|----------------------------|----------------------------|--------------------------------|-------------------------|-----------------------|---------------------|
| Reserved | \$ 214,063 | \$ 47,205 | \$ 79,858 | \$ 29,046 | \$ 492,139 | \$ 184,986 | \$ 1,047,297 |
| Unreserved Designated | 255,531 | 228,680 | 43,502 | 537 | — | 5,790 | 534,040 |
| Unreserved Undesignated | 16,359 | 38,001 | 102,721 | 187,868 | — | 26,648 | 371,597 |
| Total | \$ 485,953 | \$ 313,886 | \$ 226,081 | \$ 217,451 | \$ 492,139 | \$ 217,424 | \$ 1,952,934 |
| Percent change from prior year | 25.6 % | 28.7 % | 5.2 % | (32.1)% | 21.5 % | (36.0)% | 2.2 % |

General Fund

During fiscal year 2004, the General Fund's total fund balance increased \$99 million or 25.6 percent. This increase was due in large part to sales tax revenues coming in \$32.9 million greater than budgeted and to \$53 million being set aside in the budget and designated by the Legislature for fiscal year 2005 appropriations. In contrast, in the prior year, the Legislature designated only \$74 thousand for the next year's appropriations. The General Fund ended fiscal year 2004 with a "surplus" from unreserved and undesignated sources of \$44.8 million. However, half, or \$22.4 million, was transferred by law to the Budget Reserve Account ("Rainy Day Fund") and included in designated fund balance, and an additional \$6.1 million was carried forward by law for other purposes as designated for specific appropriation in 2005. As a result, the General Fund ended the year with \$16.3 million in unreserved/undesignated fund balance. Miscellaneous changes resulting from other designated and reserved sources account for the remaining change in fund balance. The Budget Reserve Account ended fiscal year 2004 with a balance of \$53.6 million.

Total General Fund revenues increased \$364.5 million or 10.3 percent from the prior year. Total tax collections increased \$86.6 million or 5.3 percent. The major positive changes in tax revenues were in sales tax, which increased \$73.8 million or 5.1 percent as Utah's economy continues to show signs of improvement; oil, gas, and mining severance tax, which increased \$10.1 million or 31.0 percent; and cigarette and tobacco taxes which increased \$5.6 million or 11.8 percent. The tax revenue that saw the greatest decrease was inheritance tax, which dropped \$8.5 million or 45.3 percent from the prior year. Federal funding was the largest single factor in increasing revenues for the fiscal year, as federal mineral lease revenues increased \$20.9 million or 45.1 percent, driven by higher oil prices; and federal contracts and grants climbed \$216.7 million or 14.2 percent from the prior year, driven by demand for services and higher costs as described below.

Total General Fund expenditures increased by \$255.9 million or 7.3 percent. This fiscal year's increase in expenditures is evidence of a continued high demand for government services as a result of the economic slowdown of the prior two years. The following areas were impacted most:

- *Health and Environmental Quality.* Total expenditures in this category jumped \$168.4 million, primarily due to increased Medicaid program costs resulting from increased caseloads and pharmaceutical costs.
- *Employment and Family Services.* Total expenditures in this category were up \$31.4 million as Food Stamp program costs increased 25.5 percent.
- *Public Safety.* Total expenditures in this category increased \$24.1 million, largely due to increased federal funding for emergency services and homeland security programs.

The most notable reduction in spending occurred in *Natural Resources*, where expenditures were down approximately \$12.5 million from prior year. In the prior year, *Natural Resources* had an unusual amount of expenditures related to fighting wildfires and increased spending from capital development funds for projects such as building fish hatcheries and wildlife management facilities.

Budgetary Highlights – General Fund

The Legislature adopted the initial fiscal year 2004 budget during the 2003 General Session. The original General Fund budget at the start of fiscal year 2004, excluding department-specific revenue sources such as federal grants and departmental collections, and including miscellaneous transfers, was 4.4 percent lower than the final fiscal year 2003 budget. The Legislature also had to address critical and mandated program increases, such as providing the State's matching share of projected increases in caseloads and pharmacy inflation for the Medicaid program, and increases in health, dental, and retirement rates for employees. On the positive side, revenue estimates for fiscal year 2004 showed an increase of \$19.1 million in ongoing revenue over prior year. In order to balance the original General Fund budget, the Legislature used a variety of measures including:

- Reducing the portion of agency budgets funded from general revenue sources by approximately \$70 million.
- Using \$9.8 million from the Tobacco Restricted Account (an account within the General Fund).
- Using \$3.2 million from the Commerce Service Fund Account (an account within the General Fund).

The budget was again addressed during the 2004 General Session of the Legislature (January to March 2004). General revenue estimates had increased \$30.6 million over those adopted in the 2003 General Session primarily due to federal jobs and growth relief money of \$38 million not included in the original budget. Increased revenue estimates and other additional miscellaneous revenue sources allowed the Legislature to designate \$53 million of expected excess revenue for fiscal year 2005 appropriations.

Final budgets of department-specific revenue sources increased over original budgets mostly due to an increase in federal funds as described on the previous page. Increased federal funds and corresponding expenditures resulted in the majority of the increase between original and final expenditure budgets. Final budgets for many of the departmental-specific revenue sources and related expenditures such as federal grants, departmental collections, and miscellaneous revenues, are generally revised based on actual collections. The difference between final budgeted expenditures and actual expenditures is primarily due to nonlapsing and unspent restricted funds that will be carried forward to the next year. However, \$2.1 million of unspent budgeted dollars were lapsed back to the General Fund by agencies.

Uniform School Fund

The Uniform School Fund's fund balance increased \$70 million or 28.7 percent from the prior year. While corporate taxes increased only \$4.8 million or 3.0 percent compared to the prior year, individual income taxes increased \$119.3 million or 7.5 percent; and federal funding increased by \$23.6 million or 8.2 percent. Expenditures for public education increased by \$58.4 million or 3.0 percent, as the Legislature restored base budget reductions implemented in fiscal year 2003, increased the budget for enrollment growth, and provided for increased costs related to benefits for educators and staff. The Uniform School Fund ended the year with a "surplus" from unreserved and undesignated sources of \$50.7 million. Of that amount \$12.7 million or 25.0 percent was transferred by law to the Education Budget Reserve Account, resulting in a final unreserved and undesignated fund balance of \$38 million. Established by the Legislature in 2003, the Education Budget Reserve ended fiscal year 2004 with a balance of \$13.3 million.

Transportation Fund

Fund balance in the Transportation Fund increased \$11.2 million or 5.2 percent from the prior year. Motor and special fuels taxes and fees remained relatively flat, increasing \$6.5 million or 2.0 percent. However, federal contracts and grants revenue increased \$13.6 million or 7.1 percent due to increased spending on federal participating highway projects. Federal aeronautics revenue increased \$7 million or 37.4 percent largely due to completed work on local government airport runway projects.

Total expenditures increased \$60.8 million or 11.0 percent, primarily in construction expenditures. Authorized federal funding for highway construction remains relatively stable from year to year. However, the spending of state and federal revenue reflects the timing of highway construction projects, which is impacted by a variety of circumstances such as environmental studies or weather. Also, the Department of Transportation has discretion on allocating federal funds among projects, which impacts the amount of federal revenue reported in the Transportation Fund and Centennial Highway Fund.

Centennial Highway Fund

Fund balances in the Centennial Highway Fund decreased by \$102.8 million or 32.1 percent from the prior year. Revenues in the fund dipped \$9.7 million or 13.6 percent, mostly due to a reduction of federal revenues of \$8.4 million or 19.6 percent as a result of decreased expenditures on applicable federal participating projects. No new bonds were issued in fiscal year 2004, which explains most of the decrease in fund balance from fiscal year 2003 when \$109.3 million of general obligation bond proceeds received in fiscal year 2003 were unspent as of June 30, 2003. Expenditures in the fund remained relatively flat as compared to the prior year, decreasing \$6.2 million or 3.1 percent. Still, the Department of Transportation continued to work on several major highway projects

using carry over funding from the General Fund and bond proceeds. At June 30, 2004, \$29 million of bond proceeds were unspent and included in reserved fund balance.

Trust Lands Fund

The fund balance of the Trust Lands Fund increased by \$87.1 million or 21.5 percent due to revenues generated from land use, sales of trust lands, and investment income. The permanent fund also generated \$9.6 million of cash investment earnings for the Uniform School Fund that is earmarked for distribution to local school districts. The principal in the fund is held in perpetuity, and the earnings are restricted primarily to support public education.

FINANCIAL ANALYSIS OF THE STATE'S PROPRIETARY FUNDS

Student Assistance Programs

The Student Assistance Programs finished the year with an increase of \$14.2 million or 6.8 percent in net assets. Revenues and expenditures were fairly stable, increasing 2.0 percent and decreasing 4.9 percent, respectively. However, rising tuition and other student costs, and rising enrollments at the State's colleges and universities created more demand for student loans than in prior years. As a result, loans receivable increased \$131.4 million or 11.7 percent over last year. Of total net assets of \$221.1 million, \$141.8 million is restricted for use within the Student Assistance Programs by bond covenants or by federal law.

Unemployment Compensation Fund

The State's unemployment rate has decreased slightly compared to the rate one year ago. The improving employment situation resulted in a \$65 million or 21.1 percent decrease in benefit payments from the prior year. However, benefit payments still exceeded employer taxes and other revenues. Assets were sufficient to handle the demand for benefits, but net assets decreased \$32.3 million, or 7.3 percent, to \$411.7 million. The entire balance of net assets in this fund are restricted for paying unemployment benefits by state and federal law. Continued benefit payments in excess of revenues will result in increased employer contributions, though the full effect of the increase will not be realized until future periods.

Water Loan Programs

The net assets of the Water Loan Programs increased \$27.4 million or 5.4 percent from the prior year. Additional capital for loans was provided from \$13.9 million in dedicated sales tax revenues and \$10.6 million in federal grants, in addition to net operating revenues in the fund. Tax revenues to the fund increased \$11.8 million due to the Legislature restoring dedicated sales tax revenues that had been redirected in 2003 to help balance the budget. Loans receivable for the programs increased \$10.4 million or 2.4 percent over the prior year. Of total net assets of \$539.5 million, \$217.4 million is restricted for use within the Water Loan Programs by bond covenants or by federal grant requirements.

CAPITAL ASSET AND LONG-TERM DEBT ADMINISTRATION

Capital Assets

The State's capital assets increased a net \$304.5 million during the year. The change consisted of net increases in infrastructure (highways) of \$138.8 million; land and related assets of \$43.5 million; and buildings, improvements, and construction in progress of \$125.5 million. Machinery and equipment decreased a net \$3.3 million during the year. Many buildings financed by the State are actually owned by the colleges and universities, which are component units of the State. Therefore, while the capital assets are on the component unit's financial statements, any outstanding debt issued by the State to finance construction of those assets is reported as a liability of the State's governmental activities. This in turn reduces unrestricted net assets. As of June 30, 2004, the State had \$207.1 million of outstanding debt related to capital assets of component units.

At June 30, 2004, the State had \$127.3 million in commitments for building projects in its capital projects funds, and \$442.7 million (\$250.6 million in the Centennial Highway Fund and \$192.1 million in the Transportation Fund) in commitments for highway construction and improvement projects. Funding for the commitments will come from existing resources in these funds and from future bond proceeds and appropriations.

The State has adopted an allowable alternative to reporting depreciation for roads and bridges (infrastructure assets) maintained by the Utah Department of Transportation (UDOT). Under this alternative method, referred to as the "modified approach," UDOT must maintain an asset management system and demonstrate that the infrastructure is being preserved at or above established condition levels. Infrastructure assets accounted for under the modified approach are not depreciated, and maintenance and preservation costs are expensed

The State's established condition level for roads is to maintain 50 percent with a rating of "fair" or better and no more than 15 percent with a "very poor" rating. The most recent condition assessment, completed for calendar year 2003, indicated that 74.8 percent of the roads were in "fair" or better condition. Only 6.4 percent of the roads assessed were in "very poor" condition. These results reflect improvement over calendar year 2002, when 73.0 percent of the roads were assessed as "fair" or better, and 6.6 percent assessed were in "very poor" condition.

The State's established condition level for bridges is to maintain 50 percent with a rating of "good" and no more than 15 percent of bridges with a "poor" rating. The most recent condition assessment, completed in April 2004, indicated that 70.0 percent and 3.0 percent of bridges were in "good" and "poor" condition, respectively. These results reflect no change over the prior year.

During fiscal year 2004, the State spent \$309.1 million to maintain and preserve roads and bridges. This amount is 13.6 percent above the estimated amount of \$272 million needed to maintain these assets at established condition levels.

More information about capital assets is included in Note 8 on page 79, and more detailed information on the State's modified approach for reporting infrastructure is presented in the Required Supplementary Information on page 112.

Long-term Debt

The *Constitution of Utah* authorizes general obligation borrowing only as approved by the Legislature. The *Constitution* also limits outstanding state general obligation debt to 1.5 percent of the fair market value of all taxable property in the State, while state law further restricts outstanding state general obligation debt to no more than 45 percent of the appropriations limit. As of June 30, 2004, the State was \$227.3 million below the statutory debt limit and \$1.059 billion below the debt limit established in the *Constitution*. Revenue bonds are not backed by the general taxing authority of the State, but are payable solely from specific fees or loan repayments as pledged in the bond indentures.

State of Utah
Net Outstanding Bonded Debt as of June 30
(Expressed in Millions)

| | Governmental Activities | | Business-type Activities | | Total Primary Government | | Total Percentage Change |
|--------------------------------|-------------------------|------------|--------------------------|------------|--------------------------|------------|-------------------------|
| | 2004 | 2003 | 2004 | 2003 | 2004 | 2003 | 2003 to 2004 |
| General Obligation Bonds | \$ 1,588.8 | \$ 1,713.8 | \$ — | \$ — | \$ 1,588.8 | \$ 1,713.8 | (7.3)% |
| Revenue Bonds: | | | | | | | |
| State Building Ownership Auth. | 338.9 | 334.9 | 23.5 | 22.6 | 362.4 | 357.5 | 1.4 |
| Student Assistance Programs | — | — | 1,397.5 | 1,311.0 | 1,397.5 | 1,311.0 | 6.6 |
| Water Loan Programs | — | — | 1.1 | 2.6 | 1.1 | 2.6 | (57.7) |
| Total Bonds Payable | \$ 1,927.7 | \$ 2,048.7 | \$ 1,422.1 | \$ 1,336.2 | \$ 3,349.8 | \$ 3,384.9 | (1.0)% |

The State issued \$314.8 million of general obligation refunding bonds during the fiscal year to take advantage of lower interest rates through an advance refunding. No other general obligation bonds were issued in fiscal year 2004. The decrease in general obligation debt was primarily due to timing, as bonds were issued at the end of fiscal year 2003 that typically would have been issued at the beginning of fiscal year 2004. In addition, the State issued a total of \$152.8 million of revenue bonds. Of the revenue bonds issued, \$22.7 million was to provide for capital facility construction through the State Building Ownership Authority and \$130.1 million was to provide capital for purchasing student loans in the Student Assistance programs.

The State's active management of recent economic difficulties has helped the State maintain its triple-A rating on general obligation bonds, the highest possible rating from all three national rating agencies, and double-A rating on State Building Ownership Authority lease revenue bonds from the two national agencies from which ratings were sought. These ratings save millions of dollars in interest each year because the State is able to obtain very favorable interest rates on new debt. Note 10 on page 83 contains more information about the State's outstanding debt.

ECONOMIC OUTLOOK AND NEXT YEAR'S BUDGET

Tax revenues are expected to continue to increase in fiscal year 2005; however, the State will not receive the \$38 million per year in temporary federal fiscal relief it had received the prior two fiscal years. Consequently, original general revenue estimates for the General Fund and Uniform School Fund for fiscal year 2005 were almost identical, in total, to actual revenues for fiscal year 2004. The Legislature balanced the 2005 budget mostly by using anticipated 2004 carry over funds of \$107.2 million, changing the sales tax on cable and satellite television to an excise tax, netting \$4.4 million, and utilizing other miscellaneous sources. The Legislature

provided increased funding for Medicaid, public and higher education, and for increased costs of benefits for State and higher education employees. They also provided State and higher education employees a one percent cost-of-living adjustment and a one-percent, one-time bonus.

Revenue collections to date in fiscal year 2005 are in line with original estimates.

Utah's economy is expected to moderately improve in the near future. The average unemployment rate is expected to decline in 2004 to 5.3 percent, down from an average 2003 rate of 5.6 percent. Taxable retail sales are expected to increase 7.0 percent by the end of 2004, and growth in personal income is expected to be 4.9 percent for the same period. Because these indicators are measured on a calendar-year basis, the impact on the State budget will not be fully realized until well into fiscal year 2005.

CONTACTING THE STATE'S DIVISION OF FINANCE

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact the Division of Finance, Financial Reporting Section at (801) 538-3082 or visit our Web site at: www.finance.utah.gov.

The preceding discussion and analysis focuses on the State's primary government operations. With the exception of a few nonmajor component units, the State's component units each issue separate audited financial statements that include their respective management's discussion and analysis. Component unit statements may be obtained from their respective administrative offices or from the Utah State Auditor's Office, Utah State Capitol Complex, East Office Building, Suite E310, Salt Lake City, UT 84114.